Award-Term Contracts: *Good for Business?*

The use of award-term contracts doesn't seem to represent the best interests of the U.S. taxpayer—rather, it smacks terribly of the government acquisition environment of two decades ago that preceded the passage of the Competition in Contracting Act.

BY BRETT STEVENS
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The rising number of award-term incentive-type contracts should cause concern among government acquisition professionals. Over the last six years, use of award-term contracts has expanded considerably—thanks in part to the wave of acquisition reform during the past decade encouraging adaptation of commercial best practices. But, do ultra-long business relationships forged by award-term contracts conform to all aspects of current acquisition policy or even represent the best interests of the U.S. taxpayer?

Surprisingly, it appears they may not. Rather, the use of this no-cost incentive smacks terribly of the government acquisition environment of two decades ago that preceded passage of the Competition in Contracting Act, where competition had become the exception rather than the rule in acquiring goods and services. This essay explores the competitive implications and other repercussions of the award-term contract, as well as advantages and disadvantages of their use. This article provides insight into why the award-term contract might not be in the best interest of the government from a business perspective.

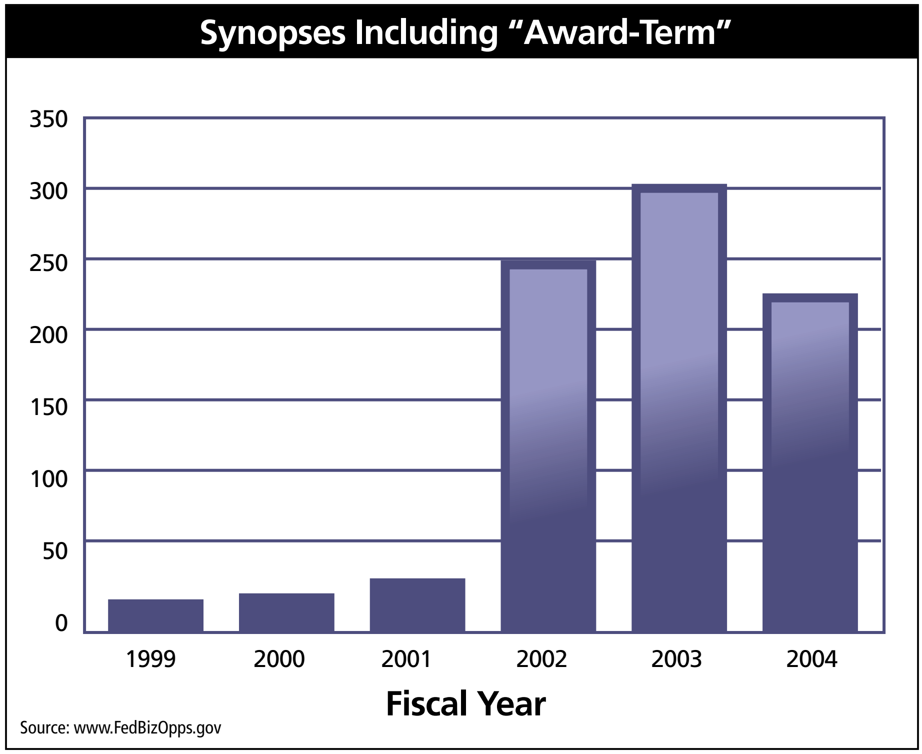

Figure 1.

The Basics

An award-term contract is comparable to the award-fee incentive-type contract found in the Federal Acquisition Regulation Part 16.405-2. Instead of rewarding a contractor for excellent performance with an additional fee, however, the award-term contract rewards the contractor by conveying the right to extend the term of the contract without having to compete for the award.

This small technicality distinguishes the award-term contract from other incentives. In essence, it says that if the contractor's performance meets the award-term criteria outlined in the contract, and if all other stipulated conditions such as continuing need and availability of funds are met, then the government must either extend the contract or terminate it for convenience or default.

To gauge how pervasive award-term contracts have become in the last six years, we conducted an informal survey based upon the methodology used by Vernon J. Edwards in early 2002. Edwards, a researcher, writer, and teacher of federal contracting, searched the synopses posted in the *Commerce Business Daily* and the announcements posted to FedBizOpps (the government point of entry for business opportunities greater than $25,000) for fiscal year 2001 postings containing the phrase "award- term."[1] Research conducted for this article expanded this search to include fiscal years 1999 through 2004, and the results are contained in **Figure 1**. The methodology included a search for the phrase "award-term" in all synopses (active and archived) across 103 government agencies.

Shortcomings to this type of informal survey were similar to those Edwards experienced in 2002—since agencies are not required to mention or describe incentive provisions in a synopsis of a proposed contract action, it is possible that the phrase "award-term" only appears in the context of the full solicitation and not the synopsis. Furthermore, mere mention of the phrase "award-term" in a synopsis does not necessarily mean the effort eventually went to contract using this method of no-cost incentive.

Notwithstanding these limitations, this informal survey reveals a marked increase in the mention of the phrase "award-term" in synopses issued during fiscal years 1999 through 2004. Language contained in the National Defense Authorization Act for fiscal year 2005, granting permission for heads of agencies to extend contracts

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beyond 10 years, may mean that use of award-term contracts will expand further still.[2]

Clearly, it appears that agencies (and the U.S. Congress) have begun to embrace this relatively new form of no-cost incentive. For insight into why this has occurred, let us look at the advantages and disadvantages of award-term contracting.

Advantages

Rewarding contractors with long-term relationships may provide a more powerful incentive than extra profit. Surely, extra profit is important to a business in reaching short-term goals. Profit earned over an extended period, however, is better aligned with the longer strategic goals of a firm, and therefore exerts greater influence on shaping contractor performance.

Those in industry tend to agree. There are numerous examples of firms that have incorporated long-term business relationships into their business models. The authors of *World Class Supply Management*, describing what it takes to become a "world-class firm," include long-term contracting and strategic sourcing as *primary considerations* in shaping supply-chain management strategy. **Table 1** lists a few contemporary firms and their supplier base, and provides credence as to the importance leading firms place on establishment of fewer longer-term relationships.[3]

Other advantages afforded by the award-term incentive include an environment conducive to capital investment and process improvement. Long-term business relationships promote stability—both for the government and industry—and motivate investment in performance-enhancing technologies. Moreover, contractors view favorably the longer timeframe in which to amortize costs. Finally, providing the same service year after year enables contractors to gain certain production efficiencies that are not generally available to contractors subject to constant churn. These efficiencies, coupled with newer technologies, enable the contractor to reduce transaction costs over the span of the contract.

For the government, new contract awards are expensive to plan, solicit, prepare, and evaluate. Besides, protests frequently delay contract award and can be a source of additional risk. Agencies can reduce their transaction costs (and their exposure to the risks associated with protests) by reducing the frequency with which they conduct new competitions for continuing service requirements.

Disadvantages

Equally important to consider are the disadvantages of the award-term contract. One long-term disadvantage is the possibility that the agents of the contracting parties will begin to conduct business on a personal instead of a proper professional basis.[4] Ethics considerations aside, this type of relationship bodes trouble. Situations resulting in an overly familiar relationship might lead to relaxed standards and an environment in which less than satisfactory results become acceptable. Unwittingly, the pressure of maintaining an amicable relationship might obfuscate good business judgment when formulating sound acquisition strategies.

The potential neglect of fiscal law is a related topic. If the award-term contract is not structured properly, an overly zealous contracting officer might inadvertently create an entitlement for the contractor in advance of funds. The potential for this occurring is related to the fact that award-term contracts actually *convey the right* of a contractor to continue work, provided certain performance criteria are met.

The associate deputy assistant secretary of the air force (contracting), faced with a rising incidence of award-term contract use, recognized this dilemma and issued a policy memorandum in March 2002 placing restrictions on their use.[5] This was only temporary, however, since the same official lifted these restrictions

Firm	Industry	Number of Suppliers	
		Not "World-Class"	"World-Class"
Xerox	Electronics	5,000	400
Chrysler	Automotive	2,500	300
Applied Materials	Computer Electronics	1,200	400
Source: World Class Supply Management			

Table 1.

one year later, after having reviewed the legality of such arrangements with the appropriate general counsel. Nonetheless, the fact that such a memorandum was issued illustrates another aspect of award-term contracts requiring careful vigilance.

Perhaps the most disadvantageous aspect of the award-term incentive is the irreparable damage caused to the industrial base. With an already shrinking industrial base, characterized as a "very serious problem" by Secretary of Defense Donald Rumsfeld, erecting one more barrier to entry appears irrational.[6] Do we really want to devise an acquisition strategy that caters only to a select few businesses? If the trend toward widespread use continues, firms not involved in long-term relationships will fall further and further behind, as those that are lucky enough to have won the long-term contract continue to improve their processes and enhance their products or services. Left unchecked, the government marketplace will appear less and less attractive to those firms considering doing business with the government until finally, these firms may be forced to leave this marketplace altogether. If these conditions persist, the government actually loses because of reduced competition.

These were the very same conditions that spawned passage of Public Law 98-369 Section 2701, which is commonly referred to as the Competition in Contracting Act of 1984 (CICA). This law was specifically enacted to increase the number of government procurements conducted under the principles of full and open competition, as opposed to contracts that are issued under noncompetitive arrangements such as "sole-source" or "set-aside" awards. CICA requires (with limited exceptions) that contracting officers promote and provide for full and open competition in soliciting offers and awarding U.S. government contracts over the simplified acquisition threshold. From the perspective of the taxpayer, maximum competition is desirable because if

Seven Exceptions to Full and Open Competition

1. Only one responsible source and no other supplies or services Awill satisfy agency requirements.
2. Unusual or compelling urgency.
3. Industrial mobilization; engineering, development, or research capability; or expert services.
4. International agreement.
5. Authorized or required by statute.
6. National security.
7. Public interest.

Source: Federal Acquisition Regulation, Part 6.302

results in timely delivery to the U.S. government of quality products and services at reasonable cost.

Contracting, absent full and open competition, is a violation of statute unless permitted and fully justified by one of only seven exceptions, as listed in the sidebar on page 32. These seven exceptions are the only statutory authorities available to restrict competition—thus, Congress has deliberately made it difficult to do so.[7]

Not Useful for Government Acquisition Professionals

It is surprising, then, to discover that use of the award-term contract has shown such remarkable growth over the last six years. A credible idea, no doubt, as long-term business relationships represent the latest in commercial best practice. As we have seen, many leading firms have adopted similar strategies in their effort to trim costs and reduce variability in their supplier base. But does the idea translate into a useful tool for government acquisition professionals? This article suggests not, for three reasons.

Reason 1: Weakens Defense Industrial Base

The defense industrial base cannot afford to be weakened further. Increased use of award-term contracts will arguably erode the industrial base because the losing firms in any given competition must wait for longer periods of time until the job is re-competed. In the meantime, if there is not sufficient government work to sustain the firm, it will be forced to look elsewhere (i.e., outside the government marketplace) for work. Moreover, when attractive business opportunities are competed less often, the small and disadvantaged businesses are no longer able to sustain themselves for any prolonged period of time and are eventually forced out of business, due to the unavailability of work.

Reason 2: Limits Competition

Award-term contracting stretches the limits of current statutory guidelines pertaining to the exceptions governing full and open competition. Award-term contracts that last longer than five years effectively limit competition for the duration of the contract period of performance. Proponents of award-term contracts lament that their use is not so radically different than using contract options. As long as the solicitation clearly states the award-term incentive and that the clauses added to the contract are modified to reflect the award-term incentive, then there should be no restrictions placed on their use.

This argument, unfortunately, does not account for the fact that competition is essentially eliminated for five years (or more)—nor does it speak to the potential problem that arises from creating a contractual entitlement in advance of funds.

Reason 3: Increases Admin Time

Despite the research demonstrating that award-terms make better incentives, one must realize that the cost savings associated with this particular commercial "best practice" is not the only concern of the government acquisition professional.

True, efficiencies are gained as a result of consolidating the supplier base into a critical mass of vendors that is capable of providing long-term support and services. But, for the government acquisition professional, certain issues transcend the objective of saving money. Federal Acquisition Regulation Part 1.102 contains "additional" guiding principles for the government acquisition professional. For example, guiding principle number two is to minimize administrative operating costs, and guiding principle number four is to fulfill public policy objectives, such as the promotion of small or disadvantaged businesses.[8]

Given these constraints, it appears unseemly that award-term contracts would make an appropriate part of any acquisition strategy, since they arguably require increased administrative oversight and do little to promote small or disadvantaged business opportunity.

Conclusion & Recommendations

In the final analysis, award-term contracts indeed pose an interesting dilemma for the acquisition professional. Understandably, this commercial "best practice" is an enticing, no-cost alternative to incentivize contractors. From a narrow perspective, it does appear as if the advantages of such an arrangement are too good to pass up. Those in favor might argue the virtues of long-term relationships and the realization of efficiencies gained by using a single contractor for a longer period of time. Undoubtedly, their argument would include a cost-benefit analysis pronouncing the scales tipped in favor of the benefits.

Those with a broader perspective, however, would argue differently. A more accurate accounting would reveal a disproportionately higher level of costs. For example, there is the cost of additional barriers to entry created by use of award-term contracts. Or, the cost to enforce countermanding government policy—most notably, the stark contrast between CICA, which promotes full and open competition, and award-term contracting, which arguably lessens the degree to which contracts can be competed. Finally, there is the cost of foregone opportunity, once federal government public policy objectives are sidelined. Not wanting to play in the federal government acquisition arena is one thing; not being able to because of policy that fails to help the little guy is quite another.

Therefore, in consideration of these largely unnoticed yet significant costs, we support limited use of award-term contracts. The decision as to the appropriateness of such an arrangement should only be made following close scrutiny of the business case. To be precise, the award-term contract ought to demonstrate measurably substantial benefits in spite of its many costs, as discussed earlier. Applying pre-determined savings thresholds, similar to those used when making decisions regarding the bundling of contracts, represents a logical extension of a methodology currently in place for decisions affecting competition. We support adopting such an approach but with the added constraint of time in which benefits are to be achieved.

At the very least, agency and procuring competition advocates must be increasingly vigilant toward the increased use of award-term contracts, and must be prepared to alert contracting officials if their use ever jeopardizes the government's best business interests. ***CM***

Endnotes

1. Vernon J. Edwards. "The Award-Term Incentive," *Federal Contracting* (February 2002). Accessed at **www.wifcon.com** on September 1, 2004.
2. National Defense Authorization Act for FY 2005, Section 813a.
3. David Burt, Donald Dobler, and Stephen Starling, *World Class Supply Management, The Key to Supply Chain Management* (New York: McGraw-Hill, 2003).
4. Vernon J. Edwards, "Award-Term: The Newest Incentive," *Contract Management*, (February 2001): 46.
5. "Use of Award-Term Contract Arrangements," Office of the Assistant Secretary, Contract Policy Memo 03-C-01, April 17, 2003.
6. Lawrence F. Skibbie, "Defense Secretary Says Industrial Base Decline Is 'A Serious Problem'," *National Defense Magazine*, (May 2001). Accessed online at **www.nationaldefensemagazine.org/issues/2001/May/Defense_Secretary.htm** on October 12, 2004.
7. *Federal Acquisition Regulation* (Part 6.302), Washington, D.C.: U.S. Government Printing Office.
8. *Federal Acquisition Regulation* (Part 1.102), Washington, D.C.: U.S. Government Printing Office.